STATE OF MICHIGAN
IN THE SUPREME COURT

Appeal from the Court of Appeals
Murphy, C.J., Fitzgerald, Borrello, J.J.

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DETROIT EDISON COMPANY,

Plaintiff-Appellee,

v.

DEPARTMENT OF TREASURY, STATE OF MICHIGAN,

Defendant-Appellant

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Supreme Court No. 148753

Court of Appeals No. 309732

Court of Claims No. 10-104-MT

**BRIEF AS AMICUS CURIAE**
**BY MICHIGAN MILK PRODUCERS ASSOCIATION**

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## STATEMENT OF QUESTIONS PRESENTED

Amicus Michigan Milk Producers will only address the second question presented by the Department of Treasury and Detroit Edison, *i.e.* when a taxpayer fully and continuously uses property for an exempt purpose, does MCL 205.94o(2) require apportionment because there is a concurrent non-exempt use?

As amicus, MMPA believes the Court of Appeals correctly held that the answer is "no."

## STATEMENT IDENTIFYING INTEREST AS AMICUS CURIAE

Michigan Milk Producers Association (MMPA) is a Michigan member-owned cooperative corporation with approximately 1,200 dairy farmer members. It markets farmers' milk for sale and remits proceeds from the sales to the dairy farmer members. MMPA operates a milk-testing laboratory that is used for testing its members' raw milk for such things as butterfat, bacterial counts, somatic cell counts, drug residues, and protein.

MMPA was the taxpayer in *Mich Milk Producers Ass'n v Dep't of Treasury*, 242 Mich App 486; 618 NW2d 917 (2000). In that case, the Department of Treasury assessed use taxes against MMPA for machinery, equipment, and supplies used in its testing laboratory. The Tax Tribunal concluded that MMPA's testing of milk was part of its agricultural production process and, therefore, the tangible personal property used in connection with testing was exempt from use tax under the agricultural production exemption in MCL 205.94(f). MTT Docket No. 240809; 1998 Mich Tax LEXIS 29 (1998). The Court of Appeals affirmed. 242 Mich App at 496.

The Court of Appeals rejected the department's argument that MMPA was not entitled to the agricultural production exemption because the testing was also conducted for non-exempt marketing purposes. The court held that "[c]oncurrent taxable use with an exempt use does not remove the protection of the exemption." *Id*. at 495 (citing *Mich Allied Dairy Ass'n v State Board of Tax Admin*, 302 Mich 643; 5 NW2d 516 (1942)).

In the appeal pending before this Court, the Department of Treasury argues that the holding in *Mich Allied Dairy* and *Mich Milk Producers* and other similar cases has been superseded by amendments to the use tax act enacted in 1999 PA 117. If the department's position is accepted by this Court, MMPA and many other cooperatives, associations, and

other entities engaged in milk and agricultural production will be substantially and adversely affected.

## STATEMENT OF POSITION AS AMICUS CURIAE

The apportionment provisions, which were added when the use tax act was amended by 1999 PA 117, do not apply when tangible personal property is continuously used for an exempt purpose.[1] The plain language of the statute does not require apportionment between concurrent exempt and non-exempt uses. When a taxpayer uses the full capacity of property continuously for an exempt purpose, the percentage of exempt use is necessarily 100%. Because the percentages of exempt use and total use are the same, there is no reasonable formula or method by which the department could limit the exemption on an apportioned or prorated basis.

## STATEMENT OF FACTS

As amicus, MMPA defers to the statements of facts and proceedings submitted by Detroit Edison and the Department of Treasury regarding the pending appeal.

The following statement is submitted as context for MMPA's explanation why MCL 205.94(2) and MCL 205.94o(2) do not require apportionment when a taxpayer continuously uses equipment for an exempt purpose.

In *Mich Milk Producers*, the Court of Appeals summarized MMPA's business operations.

> Pursuant to Membership and Marketing Agreements between petitioner and the dairy farmers, [MMPA] markets the milk for

[1] Apportionment provisions similar to those added to the industrial processing exemption, MCL 205.94o(2), and agricultural production exemption, MCL 205.94(2), were added to other sales and use exemptions by 1999 PA 117. See, MCL 205.54a(2), MCL 205.54q(2), MCL 205.54t(2), MCL 205.54u(2), MCL 205.54y(2), MCL 205.94aa(2).

> sale and remits proceeds from the sales to the dairy farmer members. Following an audit for the period July 1, 1990, through December 31, 1993, [the department] assessed use taxes against [MMPA] for machinery, equipment, and supplies that [MMPA] used in its Novi, Michigan, laboratory for testing its members' raw milk for such things as butterfat, bacterial counts, somatic cell counts, drug residues, and protein. These tests were required by state and federal health laws for the commercial marketing of milk. [MMPA]'s Novi testing laboratory was approved by the Food and Drug Administration (FDA) and the Michigan Department of Agriculture.
>
> ***
>
> The parties agree that [MMPA] is approved by the FDA and the Department of Agriculture to perform legally mandated testing of milk, without which the milk would not be eligible for marketing. The testing establishes the identity and confirms the safety of the raw milk produced on the farm.
>
> *Id*. at 487-488, 494.

The dispute over the agricultural production exemption claimed by MMPA arose, in part, because the test results were also used to determine market prices. *Id*. at 488, 495.

MMPA's current business operations are essentially the same as those described by the Court of Appeals.

## ARGUMENT

### I. When tangible personal property is fully and continuously used for an exempt purpose, the taxpayer does not lose the use tax exemption because the property is concurrently used for a non-exempt purpose.

#### A. Prior case law correctly held that "concurrent taxable use with an exempt use does not remove the protection of exemption."

In the pending case, the Court of Appeals concluded that Detroit Edison's "machinery and equipment are concurrently used in a unified system for purposes of both distribution and industrial processing." *Detroit Edison Co v Dep't of Treasury,* 303 Mich App

612, 630; 844 NW2d 198 (2014). "In such a situation, the caselaw is clear that the 'industrial processing' exemption applies to the machinery and equipment *in full*." *Id*. (emphasis in original; citing *Mich Allied Dairy*, 302 Mich at 649-651). The court continued:

> "[C]oncurrent taxable use with an exempt use does not remove the protection of exemption." *Mich Milk Producers Ass'n v Dep't of Treasury*, 242 Mich App 486, 495; 618 NW2d 917 (2000). When equipment is used from the outset in industrial processing as well as otherwise, the full exemption is to be allowed, and apportionment is not permitted "when the equipment involved is put to mixed use, but in a unified process." *Mich Bell Telephone Co v Dep't of Treasury*, 229 Mich App 200, 211-212; 581 NW2d 770 (1998).
>
> *Id.*at 632.

The Court of Appeals held DTE was entitled to the exemption in full, "despite the fact that the machinery and equipment in dispute are used, in part, for a nonexempt purpose, i.e., distribution, given that the machinery and equipment are concurrently being used to also industrially process electricity, all as part of a unified process or system." *Id*. at 631-632.

Based on the rule established in the three cited cases, the Court of Appeals' decision in *Detroit Edison* is certainly correct. A review of the three cases demonstrates why the department is wrong when arguing that the rule is no longer good law because apportionment of concurrent uses is required under the provisions added by 1999 PA 117.

In *Mich Allied Dairy*, milk was poured into bottles and cans after it was tested and sterilized, and then refrigerated to complete the sterilization process and make the milk suitable for sale to consumers. The milk was delivered in the same bottles and cans. 302 Mich at 647-648, 649-650. See *Kress v Dep't of Revenue*, 326 Mich 15, 18; 39 NW2d 235 (1949)(describing facts in *Mich Allied Dairy* as "each of the units . . . was from the very outset and constantly thereafter used in industrial processing as well as otherwise.")

This Court held that "the one use of bottles and cans in industrial processing makes them exempt from the general sales and use taxes, notwithstanding the fact that they are also put to another use not in industrial processing." 302 Mich at 650. As partial support for this holding, this Court noted that "the legislature could have provided that the portion of the value of the article representing its nonexempt uses should bear the tax, but it has not done so." *Id*. While acknowledging the Legislature's prerogative to formulate taxes[2], this Court also emphasized another key principle—"the scope of the tax laws may not be extended by implication or a forced construction." *Id*.

Specifically, a court "should neither *contract nor expand* the scope of a tax exemption by construing it according to implication." *Mich Bell*, 229 Mich App at 208 (emphasis in original; citing *Mich Allied Dairy*). Like other statutes, the provisions of tax acts are given a reasonable interpretation, and especially one that can be practically implemented. *In re Brackett Est*, 342 Mich 195, 205; 69 NW2d 164 (1955)("Nor will it be forgotten, in any question of statutory tax interpretation, that taxing is a practical matter and that the taxing statutes must receive a practical construction.")

In *Mich Bell*, the telephone company routed phone calls through its exchange equipment and station apparatus. Under the statute then in effect, MCL 205.94(t), the availability of the use tax exemption depended on whether the telephone service routed through the equipment was subject to sales tax. Some of the calls were not taxable because the consumers (*e.g.* hospitals and schools) were exempt from sales tax. 229 Mich App at 203, 208. The Court of Appeals, relying on *Mich Allied Dairy*, held that apportionment was

[2] The Legislature's authority was more recently noted in *In re Request for Advisory Opinion Regarding Constitutionality of 2011 PA 38*, 490 Mich. 295, 308; 806 NW2d 683 (2011).

not required when equipment was used in a "unified process," even though there were mixed uses. *Id*. at 212-213.

In both *Mich Allied Dairy* and *Mich Milk Producers*, the property was continuously used at full capacity for agricultural production. The milk bottles used by Michigan Allied Dairy were completely filled during processing. The equipment and supplies in MMPA's milk testing laboratory were constantly used for testing the identity, quality and safety of milk. In each case, the property was used to its full extent for an exempt purpose.

### B. The plain language of the apportionment provisions enacted in 1999 PA 117 does not apply to concurrent uses.

The department's effort in this case to extend MCL 205.94o(2) to concurrent and simultaneous uses runs afoul of the statute's plain language and aground on basic principles of arithmetic. The same is true for the similar language in MCL 205.94(2).

The two provisions state that property or services "are exempt only to the extent that the property or services are used for the exempt purposes . . . ." The term "extent" relates to "the space or degree to which a thing extends." Webster's Random House College Dictionary, p. 436 (2001). In a concurrent use situation, the property is used to its *fullest* extent for exempt purposes. *All* of the property's capacity and functionality is used the *entire time* for agricultural production in MMPA's case, and for industrial processing in Detroit Edison's.

As the Court of Appeals found in *Mich Milk Producers,* MMPA uses its laboratory equipment to test raw milk by measuring butterfat, bacterial counts, somatic cell counts, drug residues, and protein to ensure that the legally mandated standards for quality and

safety are met.[3] Whenever the laboratory equipment is used to conduct the tests, the full capacity of the equipment is completely occupied and devoted to an exempt purpose, *i.e.* agricultural production.

In discussing the concurrent use issue, the Court of Appeals imprecisely referred to "tests that determine market prices." *Mich Milk Producers*, 242 Mich App at 495. MMPA does not conduct additional or separate tests for marketing purposes. Instead, the *results* of tests performed for exempt quality control purposes can be used for pricing, *i.e.,* the butterfat and protein content of raw milk is a factor affecting price.

The department's argument is also contrary to the plain meaning of the language used in the second sentence of the apportionment provision. MCL 205.94(2) and MCL 205.94o(2) state that the exemption "is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the department." Because the full capacity of MMPA's laboratory equipment is used for testing, the "percentage of exempt use" is 100%. By definition, "total use" cannot be more than 100%.

Moreover, there is no "reasonable formula or method" for determining the percentage of exempt use to total use that would allow apportionment. The formula for determining percentage is straightforward: (% of exempt use/% of total use) x 100 = percentage. In a concurrent use situation, *i.e.* when property is fully and continuously used for an exempt purpose, the percentage of exempt use is 100%. The total use is 100%. The formula yields 100% as the percentage. Any formula or method that yielded a different

[3] More detail about testing of raw milk can be found in the Tax Tribunal opinion, MTT Docket No. 240809; 1998 Mich Tax LEXIS 29 (1998).

result would be wrong as a basic matter of arithmetic and accounting, and therefore, could not be "reasonable."

The department argues that Detroit Edison "merely invented the distinction" between concurrent and sequential uses. [Department's reply, p. 6] While the specific terms are not used in the statute, the distinction is inherent in the concept of apportionment, and from the Legislature's use of the phrase "to the extent" to describe the scope of allowable exempt use. Concurrent uses cannot be segregated or prorated. In contrast, when property is used some of the time for exempt purposes and the remaining time for taxable purposes, the extent of the sequential uses can be separated and apportioned.

According to the department's argument, this Court should conclude the Legislature intended to require something that cannot be done. However, a "law should not be read to require the impossible." *West v Northern Tree Co*, 365 Mich 402, 406; 112 NW2d 423 (1961). Moreover, as explained in the following section, the impossible and impractical apportionment advocated by the department would thwart the primary legislative purpose for granting exemptions for agricultural production and industrial processing.

### C. The apportionment provisions must be read together with the other provisions of the use and sales tax acts that are intended to avoid tax pyramiding.

The department's position also runs contrary to the language and purpose of other provisions of the use tax act. Specifically, use tax exemptions, including the exemptions for industrial processing in this case and for agricultural production in *Mich Milk Producers*, are "in part, the product of a targeted legislative effort to avoid double taxation of the end product offered for retail sale or, in other terms, to avoid 'pyramiding the use and sales

tax.'" *Elias Bros Restaurants v Treasury Dep't,* 452 Mich 144, 152; 549 NW2d 837 (1996). See also, *GMC v Dep't of Treasury*, 466 Mich 231, 237; 644 NW2d 734 (2002). The apportionment provisions should be read in context with the use and sales tax acts and in a way consistent with the legislative intent to avoid tax pyramiding. *G C Timmis & Co v Guardian Alarm Co*, 468 Mich 416, 421; 662 NW2d 710 (2003).

The case cited for that proposition in *Elias Bros*, 452 Mich at 152 n 16, is directly applicable to MMPA's agricultural production exemption. In *Int'l Research & Dev Corp v Dep't of Revenue*, 25 Mich App 8, 13; 181 NW2d 53 (1970), the Court of Appeals concluded that the cost of testing products to ensure compliance with FDA safety standards, like those performed by MMPA, "will be added to the cost which will determine the price at which the final product will be sold," and "[s]ince the intent of the exemption is admittedly to avoid pyramiding the use and sales tax, the only way to avoid this result is to recognize [the taxpayer's] claim to the exemption."

When property is continuously used at full capacity for an exempt purpose, the taxpayer includes the cost in the price of the finished good, which is subject to sales or use tax when purchased by consumers. *Id*. The cost of the property is no less because the taxpayer can concurrently use it for a non-exempt purpose. The amount paid by MMPA for the laboratory equipment and supplies continuously used for testing the identity, quality, and safety of raw milk, or the price charged for finished dairy products, is no different because the test results can be concurrently used for pricing purposes. Imposing taxes on equipment and supplies used to prepare milk for sale to consumers would result in pyramiding.

### D. The legislative history does not support the department's position.

In its reply brief, the department seeks to support its interpretation by reference to a colloquial description ("Michigan Bell fix") used in House and Senate legislative analyses. Department's reply, p. 7. As this Court has repeatedly stated, "a legislative analysis is a feeble indicator of legislative intent and is therefore a generally unpersuasive tool of statutory construction." *Frank W Lynch & Co v Flex Techs*, 463 Mich 578, 587-588; 624 NW2d 180 (2001). The reference on which the department relies is an even feebler indicator, since the shorthand description is used in a table summarizing the fiscal impact. Senate Legislative Analysis, HB 4745, June 8, 1999, p. 3; Senate Legislative Analysis, HB 4586, June 8, 1999, p. 2.

The summary of the *Mich Bell* decision in the analyses actually rebuts the department's asserted interpretation. The Senate Fiscal Agency analysis stated mistakenly that the Court of Appeals ruled "Michigan Bell was entitled to a full use tax exemption for purchases of equipment, even though *a portion of the equipment was used for nonexempt purposes*." Senate Legislative Analysis, SB 544 and HB 4744, 4745 & 4586, July 19, 1999, p 1 (emphasis added). The House analysis said—also incorrectly—"the court allowed a full exemption when equipment was *first* used for a tax-exempt purpose and *continued to be used substantially* for tax exempt purposes." House Legislative Analysis, HB 4744 & 4745 and SB 544, July 16, 1999, p. 11 (emphasis added). Those summaries describe sequential uses, where equipment is used part of the time for tax-exempt purposes and the remainder for taxable purposes. Nothing in the legislative analyses indicates that the Legislature understood or intended the "Michigan Bell fix" would apply to fully concurrent uses.

### E. The department's position is contradicted by its interpretation of the provision in RAB 2000-4.

In contrast to the meager assistance provided by legislative analyses, an agency's interpretation of a statute "is entitled to respectful consideration . . . ." *In re Complaint of Rovas Against SBC Mich*, 482 Mich 90, 108; 754 NW2d 259 (2008). The department's understanding of the apportionment allowed under MCL 205.94o(2) is demonstrated by RAB 2000-4. A revenue administrative bulletin "states the department's interpretation of the statutes." *Catalina Mktg Sales Corp v Dep't of Treasury*, 470 Mich 13, 21; 678 NW2d 619 (2004).

RAB 2000-4 was issued to explain the department's interpretation of the changes to the use tax act enacted through 1999 PA 117. After stating "the formula or method used" for apportionment must "reasonably reflect the percentage of exempt use to total use," the department presented a number of examples "demonstrat[ing] exempt use *based upon time used in an exempt activity*." RAB 2000-4, p 2 (emphasis added). *None* of the 54 examples involve concurrent use of equipment. Instead, the department explained its interpretation of the apportionment provisions with examples where a piece of equipment was used at different times for different uses.

- Examples 1 and 2 involve a forklift used part of the time for activities related to exempt industrial processing and the remainder of time for other non-exempt activities.

- Example 9 involves drafting equipment used 40% of the time to draft plans for exempt equipment (an exempt use) and 60% to draft plans for building expansion (a taxable use).

- Example 27 discusses an industrial processor that purchases a transformer which converts electricity to usable voltage. Forty percent of the energy from this transformer feeds exempt industrial processing equipment and the remaining sixty percent feeds taxable equipment used in the shipping department. According to the

department, the transformer is 40% exempt for industrial processing and 60% taxable.

- Example 29 is a printing company that uses its printing equipment 10% of the time to produce promotional brochures and office supplies which are used internally. Ten percent of the taxpayer's printing equipment would not be entitled to the industrial processing exemption.

- Example 37 involves pallets, which are used by an industrial processor 40% of the time for moving in-process materials within its plant (an exempt purpose) and 60% of the time for shipping the finished product to customers (a non-exempt purpose). The pallets would qualify for a 40% industrial processing exemption.

These examples are consistent with the department's position in *Mich Bell,* which was legislatively sanctioned in 1999 PA 117. Michigan Bell and the department stipulated that 85% of calls flowing through the equipment were made by customers subject to use tax; the remaining 15% were made by customers who were tax-exempt. The department maintained that 85% of the equipment's value was not exempt under MCL 205.94(t). *Mich Bell,* 229 Mich App at 204. The factor used to determine the taxpayer's entitlement to an exemption was the taxability of underlying services, which as the parties agreed, could be separately determined and apportioned. Under MCL 205.94o(2), there would be a "reasonable method or formula" for apportioning the exempt and taxable uses.

In contrast, the determinative factor for the exemption in *Mich Allied Dairy*, *i.e.,* the use of bottles and cans for industrial processing could not be separated from the use of the same containers for delivery. The same was true in *Mich Milk Producers*. The use of the equipment for testing milk as an integral part of agricultural production cannot be segregated from the use of test results for pricing. In the case pending before this Court, MMPA believes the Court of Appeals correctly held that machinery and equipment

concurrently used in a unified system for purposes of both industrial processing and distribution of electricity should be entitled to a full exemption from use tax.

**CONCLUSION**

As amicus, MMPA believes that the apportionment provisions enacted in 1999 PA 117 do not apply when a taxpayer fully and continuously uses tangible personal property for an exempt purpose, even if there is a concurrent taxable use.

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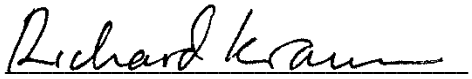

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